

UNITED STATES BANKRUPTCY COURT
Eastern District of California

Honorable Ronald H. Sargis
Chief Bankruptcy Judge
Sacramento, California

May 12, 2022 at 10:00 a.m.

1.	<u>17-22887-E-7</u> SEAN STODDARD <u>SHS-1</u> Douglas Jacobs CAREN SCALLA VS.	MOTION FOR RELIEF FROM AUTOMATIC STAY 3-23-22 <u>[90]</u>
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Tentative Ruling: Oral argument may be presented by the parties at the scheduled hearing, where the parties shall address the issues identified in this tentative ruling and such other issues as are necessary and appropriate to the court's resolution of the matter.

Local Rule 9014-1(f)(1) Motion—Hearing Required.

Sufficient Notice Provided. The Proof of Service states that the Motion and supporting pleadings were served on Debtor's Attorney and Chapter 7 Trustee on March 23, 2022. By the court's calculation, 50 days' notice was provided. 28 days' notice is required.

Federal Rules of Bankruptcy Procedure 7004(b)(9) requires service on the Debtor and his attorney; service on the Debtor's attorney alone is insufficient to require the Debtor to answer and defend. *In re Cossio*, 163 B.R. 150, 154 (B.A.P. 9th Cir. 1994)), aff'd, 56 F.3d 70 (9th Cir. 1995); *In re Bloomingtondale*, 137 B.R. 351, 354 (Bankr.C.D.Cal.1991); *In re Cole*, 142 B.R. 140, 143 (Bankr. N.D. Tex. 1992); *In re Love*, 242 B.R. 169, 171 (E.D. Tenn. 1999), aff'd, 3 F. App'x 497 (6th Cir. 2001); *In re Hall*, 222 B.R. 275, 277 (Bankr. E.D. Va. 1998).

Service here was made solely on Debtor's counsel, Tracy L. Wood via email. Dckt. 29. However, Debtor has filed an Opposition and appeared in this Contested Matter, resolving any deficiency in service.

The Motion for Relief from the Automatic Stay has been set for hearing on the notice required by Local Bankruptcy Rule 9014-1(f)(1). Failure of the respondent and other parties in interest to file written opposition at least fourteen days prior to the hearing as required by Local Bankruptcy Rule 9014-1(f)(1)(B) is considered to be the equivalent of a statement of nonopposition. *Cf. Ghazali v. Moran*, 46 F.3d 52, 53 (9th Cir. 1995) (upholding a court ruling based upon a local rule construing a party's failure to file opposition as consent to grant a motion). The defaults of the non-responding parties and other parties in interest are entered.

The Motion for Relief from the Automatic Stay is ~~XXXXX~~.

Caren Scalla (“Movant”) seeks relief from the automatic stay to allow *Scalla v. Stoddard, DPM, et al.* (the “State Court Litigation”) to be concluded. Movant has provided the Declaration of Steven H. Shultz to introduce evidence to authenticate the documents upon which it bases the claim and the obligation owed by SEAN ROBERT STODDARD (“Debtor”).

Movant has also provided a Memorandum of Points and Authorities in support of this Motion providing the legal grounds with particularity. Movant is reminded the Supreme Court requires that the motion itself state with particularity the grounds upon which the relief is requested. FED. R. BANKR. P. 9013. The Rule does not allow the motion to merely be a direction to the court to “read every document in the file and glean from that what the grounds should be for the motion.” That “state with particularity” requirement is not unique to the Bankruptcy Rules and is also found in Federal Rule of Civil Procedure 7(b).

Movant argues that relief is needed to proceed with the state court action and collect on Debtor’s insurance policy. Declaration, Dckt. 94. The court notes, although stated under penalty and perjury that everything provided in the Declaration is true and correct, Mr. Shultz’s Declaration contains statements under “belief”:

1. “It is my belief that once the Bankruptcy Court issues its order . . . the state court action will continue” Declaration at 3:2-5, Dckt. 94.
2. “It is my belief there is no prejudice . . . to [Debtor] . . . because he will incur no personal liability.” *Id.* at 3:6-7.
3. “[I]t is my belief there is no prejudice to [Debtor’s] insurance carrier . . . [t]hey have been litigating this case for over three years.” *Id.* at 3:8-11.

Mr. Schultz is reminded though allowed as a pleading device, the certification required by 28 U.S.C. § 1746 does not allow testimony in declaration to be provided under penalty of perjury being true because the witness merely “is informed and believes (or desires because likely it would mean the witness party would prevail) it is true.” The court will not consider the improper statements provided by Mr. Schultz.

DEBTOR’S RESPONSE

Debtor filed an Opposition on April 26, 2022. Dckt. 99. Debtor asserts:

- A. The automatic stay has expired and has not been reinstated since the close of the case on June 25, 2018. *Id.* at 3:3-4.
- B. The underlying debt was discharged because the case was a no asset bankruptcy and is therefore governed by the bankruptcy injunction under 11 U.S.C. § 524(a). *Id.* at 3:6-18.
- C. Movant must first obtain a judgment of liability against the Debtor in

bankruptcy court in order to proceed against the insurer. *Id.* at 4:7-15. The court notes, under the doctrine of permissive abstention of 28 U.S.C. § 1334, the court may and does choose to abstain from deciding Debtor's judgment of liability and finds the state court is the proper jurisdiction to adjudicate the matter. As this case is for medical malpractice, the court finds the state court's expertise are more suited to equitably determine the merits of the claim.

- D. Debtor's insurance does not cover intentional acts so these cannot be litigated in state court. Dckt. 99 at 4.
- E. Movant will not be able to get a revocation of discharge because such action must be brought within a year of discharge under 11 U.S.C. § 727(e). *Id.* at 4:10-13.

DISCUSSION

Automatic Stay

The filing of a bankruptcy petition creates a bankruptcy estate. 11 U.S.C. § 541(a). Bankruptcy Code Section 541(a)(1) defines property of the estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case." The automatic stay of 11 U.S.C. § 362(a) is broad in scope and applies to almost all actions taken against the debtor or property of the estate.

Movant is requesting relief from stay to move forward with state court litigation to collect upon the insurance policy. Therefore, in order to determine whether the automatic stay is in place, the court must first decide whether the insurance policy's proceeds are property of the estate. This issue is addressed below.

Discharge Injunction

Section 524 states that a discharge "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." 11 U.S.C. § 524(a)(2). The discharge injunction "protects the debtor from a subsequent suit in a state court, or any other act to collect, by a creditor whose claim had been discharged in the title 11 case." 4 Collier on Bankruptcy P 524.02 (16th 2022).

Here, the debt discharged was the personal liability of the Debtor to the medical malpractice claim. However, Movant is not requesting to proceed with litigation against the Debtor personally. Rather, Movant is requesting to proceed with litigation against Debtor's insurance proceeds. Therefore, again, the outstanding issue is whether the proceeds are property of the bankruptcy estate. If so, as this was a no asset case, the discharge injunction would prevent Movant from moving forward with state court litigation.

Insurance Proceeds and Property of the Estate

Ninth Circuit case authority suggests that insurance policy proceeds that are potentially going to be paid to third-parties are not property of the estate. *In re Endoscopy Ctr. of S. Nev., LLC*, 451 B.R. 527, 543 (Bankr. D. Nev. 2011); See generally *Liberty Mut. Ins. Co. v. Official Unsecured Creditors' Comm. of Spaulding Composites Co. (In re Spaulding Composites Co.)*, 207 B.R. 899 (B.A.P. 9th Cir. 1997).

The Fifth Circuit Court of Appeals provides a guiding explanation for insurance policies and whether they are property of the estate. *Martinez v. OGA Charters, L.L.C. (In re Charters, L.L.C.)*, 901 F.3d 599 (5th Cir. 2018). In *Martinez*, the tortfeasor owned an insurance policy that provided liability coverage. The court found while a debtor's liability insurance policies are property of the estate, "when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate." *Id.* at 603 (citing *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 56 (5th Cir. 1993)). Under 11 U.S.C. § 541, the Fifth Circuit finds the policy itself is property of the estate, however, the proceeds of the policy are not, unless the proceeds are over and above the policy limit. *Id.* (stating if proceeds are over and above the policy limit it may threaten the estate, giving rise to an equitable interest of debtor under 11 U.S.C. § 541(a)(1) in having the proceeds apply to satisfy as much of the claims as possible).

Collier on Bankruptcy agrees in line with the Fifth Circuit's reasoning, stating:

Despite this history, the court in *OGA* opined that the matter of whether proceeds of liability insurance policies are property of the estate is fact-specific, and that the insurance proceeds are property of the estate "when the policy limit is insufficient to cover a multitude of tort claims." The reasoning may be criticized for conflating the property of the estate issue with the amount of the insurance coverage relative to the claims against the debtor that would be covered by the insurance. The two should be independent, one from the other.

5 Collier on Bankruptcy P 541.10 (16th 2022).

The court agrees with Collier and the aforementioned cases. Insurance proceeds are property of the estate only if the debtor has a "legal and equitable" interest in the property at the beginning of the case. 11 U.S.C. § 541(a)(1). If the proceeds are only going to the third-party, there is no interest for the debtor.

Medical malpractice insurance exists for the direct situation at hand: when a patient believes they were wrongfully treated, a doctor's insurance can cover the claim to make the loss manageable for doctor. Medical malpractice insurance provides economic feasibility for a doctor and their practice. If medical malpractice insurance were not available, the risks for doctors would be insurmountable.

The court does not find the insurance company should profit from Debtor's bankruptcy discharge by no longer being required to fulfill their contractual obligations under their insurance contract with Debtor. Movant is requesting to proceed with state court litigation to recover on a medical malpractice claim "limited to insurance proceeds." Movant is not requesting for what is over and above the policy limit. Additionally, if Movant is successful in the litigation, the proceeds are only being payable for the benefit of Movant, not to the benefit or detriment of Debtor. As such, Debtor has no cognizable interest in the proceeds. Therefore, the insurance proceeds are not property of the estate.

The court finds Movant is able to move forward with state court litigation to recovery from Debtor's insurance policy.

COURT DRAFTED ORDER

Given the aforementioned law and reasoning, the court finds there is no automatic stay on the insurance proceeds as they are not property of the estate. Therefore, Movant is not entitled to relief from the automatic stay. Additionally, as insurance proceeds are not property of the estate, Movant is allowed to move forward with state court litigation for the limited to the policy limit of Debtor's insurance proceeds without violating any discharge injunction.

At the hearing, counsel for Movant addressed the distinction between negligence covered by Debtor's insurance and the intentional tort claims. ~~XXXXXXXXXXXXXXXXXXXX~~

The court shall issue an order confirming there is no automatic stay and Movant will not violate the discharge injunction to allow Movant to continue the State Court Litigation.

No other or additional relief is granted by the court.

The court shall issue an order substantially in the following form holding that:

Findings of Fact and Conclusions of Law are stated in the Civil Minutes for the hearing.

The Motion for Relief from the Automatic Stay filed by Caren Scalla ("Movant") having been presented to the court, and upon review of the pleadings, evidence, arguments of counsel, and good cause appearing,

IT IS ORDERED that the automatic stay provisions of 11 U.S.C. § 362 with respect to the insurance proceeds subject of the state court litigation in *Scalla v. Stoddard, DPM* are not in effect pursuant to 11 U.S.C. § 521(a)(1).

IT IS FURTHER ORDERED that Movant is not in violation of the discharge injunction under 11 U.S.C. § 524, allowing Movant, its agents, representatives and successors, and trustee under the trust deed, and any other beneficiary or trustee, and their respective agents and successors to proceed with litigation in *Scalla v. Stoddard, DPM, et al.*, with recovery limited to the policy limit of Debtor's insurance proceeds and recovered only from the insurance company.

This court has continuing jurisdiction to address violation of the discharge injunction by any person, which could include an insurance company refuses to provide defense and coverage for a person who has been a bankruptcy debtor..

No other or additional relief is granted.